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Weekly Commentary, Selected Financial Data, and Business Indicators

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Some Contradictory Developments . . .

Both short- and long-term interest rates continued to be buffeted by a variety of positive and negative economic developments in recent weeks, with elements of each underlying the near-term outlook. Among the more important: The relatively subdued growth of the monetary aggregates, apprehension over the ability of the Administration to implement substantial nonmilitary spending cuts and, ultimately, balance the Federal budget, contradictory signals emanating from the economy and a fading of business loan demand at the nation's commercial banks. These developments have produced a slight easing of short-term interest rates while, at the same time, exerting strong upward pressures on long rates.

First, the growth of the money supply remains subdued. During the most recent week, for example, M-1A dropped $500 million, bringing the total decline since January 1 to $13.5 billion, while M-1B rose $1.8 billion. Although M-1B has increased by $8 billion since January 1, most of the gain occurred during the first week of the month, and, in fact, this aggregate now stands only slightly above its early-December levels. What is more, this increase is extremely modest when viewed against the backdrop of a $21.6 billion bulge in other checkable deposits outstanding (primarily NOW accounts) during the same period, clearly indicating that the transactions demand for funds has turned sluggish.

While the performance of the monetary aggregates in recent weeks implies that the Federal Reserve will probably not have to tighten monetary policy further over the near term, it is equally unlikely that a more accommodative policy stance will soon be adopted. The central bank is aiming for relatively low monetary growth targets for the first quarter of 1981. For M-1A, this target has been set at 4-1/4 per cent and for M-1B 4-3/4 per cent. Although M-1A has contracted at a more than 45 per cent seasonally-adjusted annual rate during the quarter to date, M-1B has expanded at a 9.1 per cent pace—well above the short-run target set by the Fed.

Second, Federal budget developments have also recently exerted both a positive and a negative influence on the financial markets. On the positive side, prospects for substantial nondefense spending cuts have tended to buoy the markets. In addition, an emerging reluctance by some in Congress to support immediate personal income tax cuts has clouded the prospects for the passage of such tax relief, providing more "good news" to those who favor a postponement of tax cuts which are not simultaneously matched by large spending cuts.

The negative news, in contrast, was highlighted by the announcement of the December, 1980 budget outcome (Financial Digest—February 2, 1981). With income security expenditures—especially inflation-indexed Social Security payments—rising rapidly, spending exceeded revenues by $7.3 billion, almost five times the size of the December, 1979 deficit. This brought the fiscal year to date red ink total to a whopping $33.6 billion, more than $9 billion higher than the deficit posted during the comparable period of fiscal 1980. If these trends persist, the budget deficit for the fiscal year as a whole could reach almost $80 billion, and the associated Federal government borrowing requirements would surge over the $100 billion mark.

. . . Cloud The Interest Rate Outlook

Third, unfolding economic developments added to confusion in the financial markets. Although the drop in the index of leading economic indicators in December and the fading of industrial production in January suggested at least a slowing of economic growth from its robust fourth-quarter pace, retail sales statistics and labor market developments continue to point toward an underlying resiliency in the economy. Specifically, retail sales increased two per cent in January, while total employment was up by 414,000 during the same month.

Finally, short-term business loan demand at the nation's commercial banks has softened. Commercial and industrial loans outstanding at large weekly reporting banks rose at a seasonally-adjusted 4.7 per cent annual rate during the past month, well below the more than 14 per cent annual rate of gain posted during the past 13 weeks. The slowing of loan growth at commercial banks should bolster the money markets, since it can be expected to reduce the scramble by banks for purchased funds.

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Despite the slump in bank loan demand, however, total short-term credit demands (C & I loans plus commercial paper) continued to surge, expanding at a more than 50 per cent, seasonally-adjusted annual rate during the month ending February 4. This gain largely reflects a renewed upturn in commercial paper issued by nonfinancial companies, which during the same four weeks, increased $1.1 billion, adjusted for seasonal variation. Thus, while the slowing of bank loan demand may be "good news" for the financial markets, this development apparently reflects the switching of short-term credit demands from the banks to the commercial paper market, rather than a significant abatement of credit requirements.

Although the likelihood of another drop in real GNP may have receded, any growth is likely to be less than the four per cent gain posted in the fourth quarter. This, in turn, should prompt a modest-sized rally in the financial markets in coming weeks, with short-term interest rates declining irregularly as the economy softens and the demand for funds recedes. The bond markets may also strengthen, but not until the likelihood of the Administration's budget cuts becomes more apparent and the slowing of the pace of economic activity becomes more pronounced. But whether such a rally can be sustained in light of the still dismal inflation outlook and massive Federal government borrowing requirements remains to be seen.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/11/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	124.596	– .880	+ 1.806
Loans to Depository Inst.	1.113	– .088	– .126
Float	3.502	+ .455	– 1.479
Total Reserve Bank Credit	139.607	– .025	+ 5.142
Treasury Deposits with Federal Reserve Banks	3.926	+ .638	+ .199
Currency Outside Banks	118.082	+ .892	+ 8.092
Member Bank Reserves:			
Required	38.926	– 1.295	– 3.605
Excess (Deficiency)	.230	+ .002	+ .401
Total Reserves Held	39.156	– 1.293	– 3.204
Net Borrowed Reserves	.752	– .096	– .564
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	93.445	+ .364	+13.438
Monetary Aggregates†		**% Change Since Three Months Ago***	**% Change Since Year Ago**
M-1A	365.7	– 20.9‡	– 1.1‡
M-1B	416.1	+ 1.1‡	+ 6.7‡
M-2 (January '81)	1,683.0	+ 6.6	+ 9.7
L (November '80)	2,346.5	+ 11.7	+ 9.8

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 2/20/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	14.15%	13.50%	12.60%
* Federal Agencies	15.07	15.36	14.70
* Project Notes—Taxfree (46% Taxable Equivalent)	11.57	11.67	12.78
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	14.75	14.75	

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	10.00%	Mar.	15.00%
15- 29 days	12.75	Apr.	14.90
30- 59 days	14.63	May	14.80
60- 89 days	13.00	Jun.	14.70
90-119 days	14.50	Jul.	14.60
120-179 days	14.00	Aug.	14.50
180-270 days	13.00		

‡Industrial Paper—Prime		†Federal Funds Effective Rate	14.65%
30- 89 days	15.00%		
90-120 days	15.00		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'80	$ 2,732	$ 2,637	$ 2,496
Gross National Product (1972 Dollars)*	4th Q'80	$ 1,487	$ 1,472	$ 1,491
Percent Change, Annual Rate	4th Q'80	4.0%	2.4%	0.6%
Change in Consumer Prices (all urban consumers)*	Dec '80	13.2%	12.0%	14.4%
Change in Producer Prices*	Jan '81	10.8%	6.0%	19.2%
Civilian Employment (Thousands of Persons)†	Jan '81	97,696	97,282	97,708
Unemployment as % of Civilian Labor Force†	Jan '81	7.4%	7.4%	6.2%
Personal Income*	Jan '81n	$ 2,298	$ 2,277	$ 2,077
Leading Indicators Composite Index (1967=100)†	Dec '80	136.6	137.7	135.2
Industrial Production Index (1967=100)†	Jan '81n	151.8	150.9	152.7
Net Change in Consumer Installment Credit†	Dec '80	$ 1.62	$ 0.84	$ 2.03
U.S. Merchandise Trade Balance†	Dec '80	–$ 2.06	–$ 0.79	–$ 2.87
Plant and Equipment Expenditures*	1st Q'81	$310.59(a)	$297.30(a)	$291.89
Private Housing Starts (Thousands of Units)*	Jan '81n	1,585	1,532	1,389
New Construction Expenditures*	Dec '80	$ 241.6	$ 231.6	$ 244.0
Total Business Inventories†	Dec '80	$ 457.0	$ 458.0	$ 426.8
Total Business Sales†	Dec '80	$ 332.2	$ 329.0	$ 302.1

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

The Strong Dollar . . .

In spite of occasional small downward adjustments, the United States dollar continues its strong upward trend in a very volatile foreign exchange market. By early last week, the dollar had risen 27 per cent from its level against the German mark in mid-July, 1980. The dollar also reached an all-time peak against the Italian lira on February 16 when the spot rate was 1,038 lire to the dollar. Even the Swiss franc, which has an enviable reputation as a stable store of value, touched two to the dollar, its lowest level in three years, before moving up slightly. The French franc, in spite of a high rate of inflation in France (13.5 per cent in 1980), is at the top of the European Monetary System (EMS). It sold for over five to the dollar last week. And while the pound sterling and the Japanese yen have retained most of their value against the dollar, even these currencies have shown some erosion in recent weeks. The pound, which was worth over $2.44 in early November, had dropped to close to $2.26 by last week. The Japanese yen was at its recent high point in early January when it reached 199 to the dollar. Since then it has fallen to 207 to the dollar.

Why this surprising strength? There is no single, simple explanation, however, an important consideration is the real interest rate differential favoring dollar-denominated assets when compared with other currencies. Even though short-term interest

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (2/4/81)	116,542	– 1,128	+23,745
New York City (2/4/81)	29,235	– 360	+ 8,992
Commercial Paper (2/4/81)	130,129	– 298	+11,280

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/4/81)	171,892	+ 478	+12,796
New York City (2/4/81)	50,845	+ 165	+ 3,066

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/4/81)	426,752	+ 803	+27,305
New York City (2/4/81)	100,987	+ 1,465	+11,486

Financial Markets

	Friday 2/20/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	14.08%	– 2.24	+ .15
180-Day Bills†	13.42	– 2.73	– .96
Longest Bills†	12.56	– 2.45	– 1.96
Recent Issues:			
13⅝s 1/31/83	13.52	– .98	
13¼s 8/15/84	13.22	– .78	
13s 11/15/90	13.06	– .56	
12¾s 11/15/10	12.51	– .56	
Municipals:			
Bond Buyer–20 Bond Index* (2/19/81)	10.22%	+ .23	+ 1.76
Blue List Total ($ Million)	$ 715	+ $ 14	+ $ 64
30-Day Visible Supply ($ Million)	$2,234	– $ 12	+ $ 315
Total	$2,949	+ $ 2	+ $ 379
Corporates:			
Moody's Aa Composite (2/19/81)	14.02%	+ .24	+ .96
Money Mgr.–30-Day Supply ($ Million)	$4,547	+ $459	+ $2,998
Stocks:			
Dow-Jones Averages:			
Industrials	936.09	+ 4.52	+ 67.32
Transportation	379.18	– 10.19	+ 90.18
Utilities	107.27	– .84	– 3.66
65 Stocks	358.59	– 2.45	+ 40.04
Standard and Poor's 500 Stocks	126.58	– .40	+ 11.54
N.Y.S.E. Composite Index	72.45	– .35	+ 6.65
N.Y.S.E. Avg. Daily Vol. for Week (000's)	39,166	+ 2,092	– 6,902

* 46% Taxable equivalent 18.93%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/20/81	Week Ago
Overnight	16.50%	17.38%
1 month	16.13	17.88
3 month	16.25	18.25
6 month	16.25	18.19
1 year	15.50	17.06
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	13.70%	13.80%
Long Term (7 to 15 yrs.)	13.50	13.60

FOREIGN EXCHANGE SPOT RATES New York Opening (2/20/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02948	33.92
Canada	.8355	1.1969
Denmark	.1541	6.4900
France	.2046	4.8875
Germany	.4762	2.1000
Italy	.0009940	1006.00
Japan	.004866	205.50
Mexico	.04257	[illegible].49
Netherlands	.4357	2.2950
Switzerland	.5294	1.8890
U.K.	2.3085	.4332

rates in the U.S. have declined from their recent highs, the dollar has strengthened. The virtual certainty that the U.S. ran a substantial current account surplus in 1980 and the strong probability of an even greater surplus in 1981 add underlying strength to our currency. Foreign exchange markets move on psychological factors as well. Dealers perceive a favorable economic environment under the Reagan Administration and anticipate a period of stable though low growth.

But there are no fixed points in the foreign exchange markets; rates are determined by relative, not absolute factors. Investors have moved from other currencies to the dollar because the economic environment looks relatively better. For example, much of the recent weakness of the German mark is not due to the intrinsic merits of the dollar, but rather because the near-term outlook for the German economy is for recession, relatively high unemployment, high inflation (by German standards) and another large current account deficit, perhaps $10 to $12 billion in 1981 after a $15 billion deficit in 1980. Political uneasiness in Poland and in the Middle East further clouds the situation. Germany's great dependence on imported energy lies at the heart of the problem of the dollar/mark exchange rate. A stronger dollar exacerbates it by adding to the cost of imports (thus increasing the current account deficit) in terms of the mark.

. . . Is A Mixed Blessing

The strength of the dollar is not entirely beneficial to the U.S., either. One of the major contributors to the U.S. current account surplus has been the astonishing growth of exports in the last several years when the dollar was relatively weak, encouraging other countries to buy our goods. Many of our manufactured exports are capital goods (e.g. aircraft, computer, etc.) which have long periods between the time when they are ordered and when they are delivered. We are now reaping the benefits that lag. But the reverse is true as well. A stronger dollar could discourage new orders which may be due for delivery in one or two years. Fortunately, the demand for a substantial part of our exports is relatively inelastic, that is, they tend to be ordered in spite of price increases. Agricultural exports are a case in point, as are essential energy needs. Although the major portion of our agricultural exports is sent to traditional markets year after year, a poor harvest in a major country can result in a sudden and surprising increase in export volume and prices for American farmers.

Another problem which a strong dollar creates particularly in an economy that is growing, albeit slowly, is that it encourages imports into the United States as their relative cost declines in dollar terms. This not only has adverse effects on the U.S. balance of payments, but it also makes U.S.-made products relatively less competitive in the domestic market as well as in overseas markets. Thus, the strong dollar is a mixed blessing. H

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